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dcrac

Your Fair Lending Advocate in Delaware!

DELAWARE COMMUNITY REINVESTMENT ACTION COUNCIL, INC.

Our mission is "to ensure equal access to credit and capital for the under-served populations and communities throughout Delaware through Education, Outreach, Advocacy, and Legislation."

March 27, 2006

Docket No. 05-21
Attention: Public Information Room, Mail Stop 1-5
Office of the Comptroller of the Currency
250 E. Street SW
Washington, DC 20219

Docket No. OP-1246
Jennifer J. Johnson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Robert E. Feldman, Executive Secretary
Attention: Comments
Federal Deposit Insurance Corporation
550 17th Street, NW
Washington, DC 20429

Attention: Docket No. 2005-56
Regulation Comments
Chief Counsel's Office
Office of Thrift Supervision
1700 G Street NW
Washington, DC 20552

Re: Interagency Guidance on Non-traditional Mortgage Products

Dear Sir/Madame:

On behalf of the Delaware Community Reinvestment Action, Council, Inc., (DCRAC), a fair lending advocate in Delaware, we appreciate the formalized warnings to the lending industry on the risks and potential harm of inappropriate and excessive issuance of nontraditional mortgages.

Standing alone, these exotic mortgage products may not be such a grave issue. They become a serious concern when made to the unsophisticated borrower.

The market today is flooded with exotic mortgage products: interest-only loans, option adjustable-rate mortgages (ARMs), adjustable rate mortgages, no documentation mortgages, no down payment mortgages, pick your payment options, and so forth.

These products are already becoming main stream. *Washington Post* reports that in 2005, 63% of new mortgages were interest-only and adjustable-rate mortgages. *New York Times* reports that over an 18-month period in 2004 and 2005, approximately one-third of homebuyers did not put any money down for their loan.

These products are unsuitable to the unsophisticated borrower who can not comprehend the potential payment shock, negative amortization, loss of equity and the ultimate risk of losing the home.

We believe that borrowers' repayment capacity must be conservatively assessed through carefully reviewing loan-to-value (LTV) and debt-to-income (DTI) ratios, credit scores, and borrowers' income levels. In addition, lenders should conduct stress tests that include assessing borrower ability to repay at interest rates higher than the fully indexed rate.

Minimum Payments

We agree that lenders must underwrite loans involving minimum payments with extreme caution. This option is like buying a home with a credit card. Even if it may make sense for some borrowers, the minimum payment has to be sufficient enough to make sense. After all the agencies have recommended that credit card lenders raise the minimum payment required of all borrowers!

Lenders need to assume that large and increasing outstanding balances will confront borrowers who choose minimum payments. We agree that the lending industry must underwrite these loans as if at some point in the near future there will be a large outstanding balance for loans with minimum payments.

In addition, we ask the regulators to set a limit on the amount the outstanding loan balance can increase as the loan negatively amortizes. We suggest that outstanding balances be capped at 105% of the original loan amount for loan products that permit negative amortization.

Stated Income

We do not see any benefits to combining stated income loans or loans with reduced income documentation with any nontraditional mortgage and/or with any subprime mortgage.

If this product is allowed,
1) It should not be offered in combination with any other risky product.
2) It should not rely solely on credit scores as a substitute for income verification.
3) It should require low LTV, low DTI ratios, and high credit scores.

Consideration of Future Events

Future events should only be considered in borrowers' ability to repay to the extent that they are predictable, likely, and relevant.

Estimating future incomes, for example, should not be considered in this calculation as it is not a reliable, foreseeable or necessarily likely event. If at all, given the realistic environment of globalization, downsizing, and real loss in incomes, projections of future incomes should be conservative.

Estimating future debt should be in the context of our recent experience. For example, we could barely handle a rate shock of $3/gallon gasoline! Delawareans are poised for a rate shock of 59% increase in utility bills. Future interest rates should be a consideration in an environment where we are poised for the 15th straight rate hike.

When ARMs first came out in the 1980s, lenders protected themselves and borrowers from risk by calculating some extra cushion into the analysis of the borrower's ability to repay. Lenders should continue this responsible lending effort by assessing borrowers' ability to repay at 2 percentage points beyond the fully indexed rate or at the capped rate, whichever is greater.

Underwriting Standards

We are pleased with several of the proposed guidelines to set higher industry standards on underwriting, consumer protections, and portfolio management practices.

We agree with your proposals that:
* Lenders should avoid making unrealistic loans that effectively force borrowers to refinance or sell their homes once amortization begins.
* Lenders should be curbed from making simultaneous second-liens that allow for negative amortization when there is minimal or no invested equity.

* Lenders should sufficiently compensate for risk layering and to carefully come up with ways to minimize impending payment shock for borrowers with low introductory rates.
* Lenders should compensate for risk layering through a combination of higher credit scores, lower LTV and DTI ratios, and credit enhancement.
* Lenders must develop strategies for managing the payment shock by eliminating large disparities between low introductory rates and adjustable rates.

Managing Portfolio Practice

We support:

* The requirement that lenders monitor their third-party relationships to ensure that these agents follow lenders' policies and procedures.
* Lenders must immediately sever ties with third-party originators if harmful lending practices are discovered. We recommend that regulators review lenders on their compliance with these guidelines during their fair lending and safety and soundness reviews.

Consumer Protection Issues

We appreciate the clarification that lenders should provide clear, balanced and timely communication, explain available options and their associated increases and impacts in monthly payments, and specifically describe features such as payment shock, negative amortization and prepayment penalties.

Even the best disclosure requirement is simply not enough. We urge you to augment strong consumer disclosure requirements with tough regulations and enforcement.

Thank you for reminding lenders about their continued legal responsibilities to borrowers, even after loans are sold or securitized.

Sub Prime Borrowers

Nontraditional mortgages pose heightened risk to subprime borrowers. Already starting with higher interest rate loans, subprime borrowers are often more sensitive to rate fluctuations than prime borrowers. Yet, lenders inappropriately target subprime borrowers for these risky products. We urge you to prohibit lenders from offering risky nontraditional mortgages to subprime borrowers that allow for negative amortization, risk layering or similarly dangerous features.

Community Reinvestment Act

We urge you to incorporate the Community Reinvestment Act (CRA) into the proposed guidance. CRA mandates lenders to respond to credit needs in a safe and sound manner. The guidance must therefore stipulate that issuing nontraditional mortgages in an unsafe and unsound manner violates CRA. Lenders must be penalized via lower ratings on their CRA exams for making exotic mortgages that are unsafe and unsound. The recent changes to the CRA regulation include a new provision that penalizes lenders for discriminatory, illegal and abusive loans. Therefore, regulators must ensure that lenders are not targeting minorities and other protected classes with dangerous and ill-suited exotic mortgages. Lenders targeting minorities, women, elderly, or low-income borrowers with exotic mortgages must be given a lower rating on their CRA exams and reported for violations of fair lending and equal credit opportunity laws.

We remain concerned that risky nontraditional mortgages are becoming commonplace for the average borrower, and too common for low- and moderate-income and sub-prime borrowers who are extremely vulnerable to risky products.

We sincerely appreciate your efforts to gain control of the ever-growing trend of risky nontraditional mortgage products and request that you keep borrowers' best interests in mind when finalizing the guidelines.

Thank you for the opportunity to comment on this proposal. If you have any questions, please do not hesitate to contact us at (302) 654-5024.

Sincerely,

Rashmi Rangan